J.P.Morgan

Economic Research
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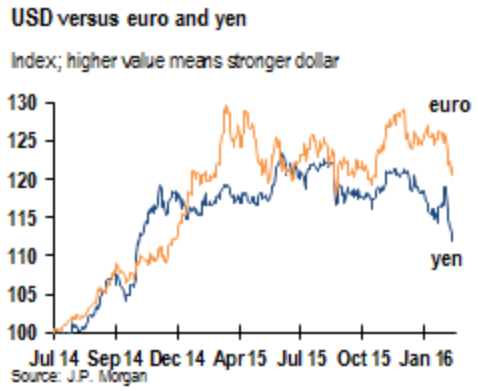
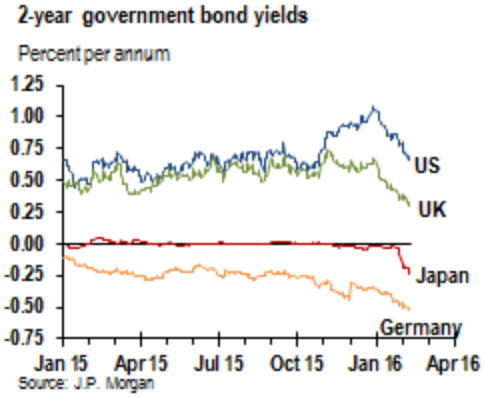
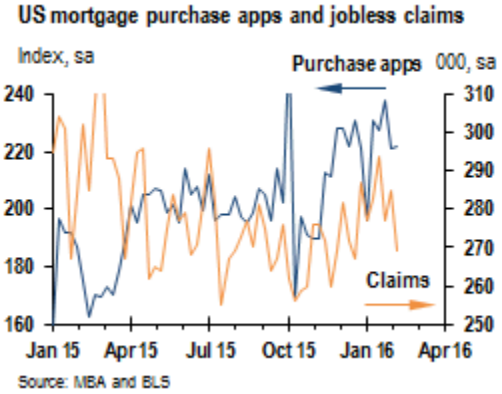
Daily Economic Briefing:

Rushing to ease

- The European push into negative interest rates continued with today's action in Sweden, where the Riksbank cut its repo rate by 15bp to -0.5%. The policy rate path was also reduced substantially to suggest rates will remain negative through 2017, reflecting a substantial downward revision in the inflation forecast. At the same time, our colleague Raphael Brun-Aguerre says the bar for further action has been raised with two members having dissented today. One consideration is potential feedback from future ECB actions. This week we changed our ECB call to incorporate more aggressive easing at next month's meeting. We now look for a larger deposit rate cut of 20bp, taking it to -0.5%, along with an increase in the monthly pace of QE purchases by €10bn to €70bn/month, a three-month extension of the QE program to mid-2017, and two additional TLTROs during 2H16.
- Our Japan team thinks the BoJ will ease again next month as well. The yen has surged against the dollar over the past two weeks despite the BoJ's surprise rate cut on January 29. This tightening in financial conditions (yen, Nikkei) is an added hurdle for the economy and for the BoJ's inflation objective and our colleagues now think the BoJ will ease at the March 15 meeting, cutting the IOER to -50bp from -10bp, with an increase in JGB purchases (to JPY100tn from JPY80tn), ETFs (to JPY6tn from JPY3tn), and J-REITs (to JPY200bn from JPY90bn).
- Our forecasts still anticipate near-term monetary tightening in the Andean countries. Inflation is running above target, partly due to FX depreciation related to the importance of commodity exports to their economies. Central banks are concerned about the impact of inflation overshoots on expectations and have been raising rates. We look for a 25bp hike at today's meeting in Peru and for the BCRP to keep its tightening bias. We expect Chile's central bank to take a pass today but we still look for a hike in 2Q16.
- There are several important economic reports to watch for. Today's update on US initial jobless claims was quite positive. The weekly reading fell back to 269,000. If claims can hold near this level they will be close to the expansion lows of 260,000 or so set in October. Just weeks ago, the surge in claims set off alarm bells. That move increasingly looks like it was related to faulty seasonal adjustments. Tomorrow brings January US retail sales. We are counting on a broad acceleration in DM retail sales during 1Q following a surprising slowdown in 4Q15. We also have GDP reports for the Euro area (JPM: 1.25%) and Japan (JPM: 0.5%) tomorrow and Monday. We think risks are skewed to the downside for the 4Q15 GDP forecasts.







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Profit margins slipping though not sliding

MSCI data suggest that global profit margins have been drifting lower for the past two years. In the big picture, our main takeaway from these data continues to be the extreme divergence between the DM and the EM. Margins in the DM have been fairly elevated over the past five years in contrast with the severe decline that took place in the EM. Though pricing power is weak everywhere, DM companies have done a better job of managing their unit costs (i.e., the difference between the growth of hourly wages and labor productivity).

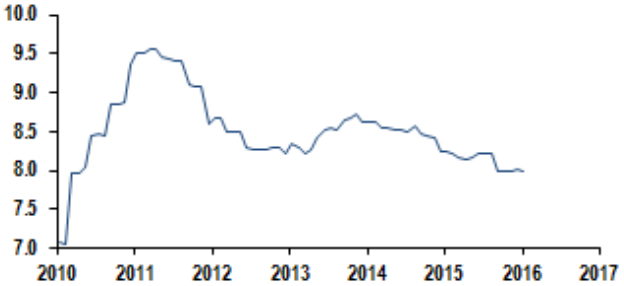
With that backdrop in mind, the MSCI data show that some changes recently have taken place. DM margins have begun to fall as US corporates come under pressure from the rising dollar and the concentrated hit to the energy sector. Euro area and Japanese businesses have been spared these drags and their margins appear to be fairly stable.

More surprising, the MSCI data indicate that EM profit margins have begun to level off. Our calculations show that EM labor productivity growth is zero or even negative, albeit for a limited subset of countries (which excludes China). With pricing power also depressed, especially in light of the further decline in global metals and energy prices, it seems odd that margins have stabilized. To be sure, EM labor markets have weakened and it is likely that wage growth is moderating, which would support margins. But our intuition is that the net of these factors still points to falling margins.

The EM profits data need to be qualified. EM stock markets do not comprise a representative sample of companies the way the US stock market does. In many countries stock market capitalization is limited and the companies that are publicly traded tend to be in select groups such as banks, retailers, and commodity exporters. The quality of the EM earnings data also may be lower than for the DM. For example, when we exclude China from the EM, the MSCI data show that margins continued to fall through most of 2015, more in line with our priors.

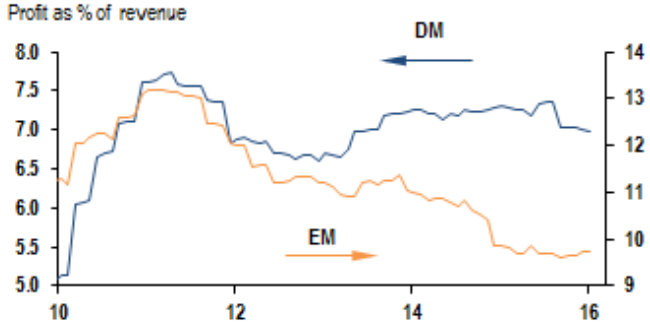
With all that said, even if EM margins are not falling any more, their depressed level is a big problem for the regional economy. Margin compression has interacted with the buildup of private sector leverage, driving up NPLs and causing banks and markets to curtail the flow of credit. The result is a negative feedback loop that has depressed EM economic growth.

Global profit margins
Profit as % of revenue



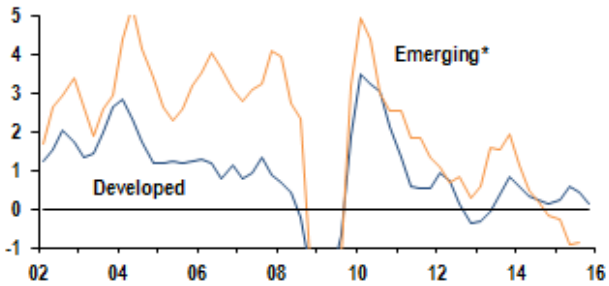
Source: J.P. Morgan

Global profit margins
Profit as % of revenue



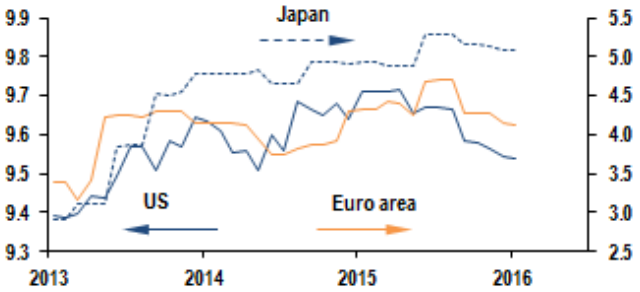
Source: J.P. Morgan

Labor productivity
%oya



Source: J.P. Morgan; *Productivity is GDP/Employment (excludes Chn, Ind). 4Q15 for DM is an est

DM profit margins
Profit as % of revenue; both scales



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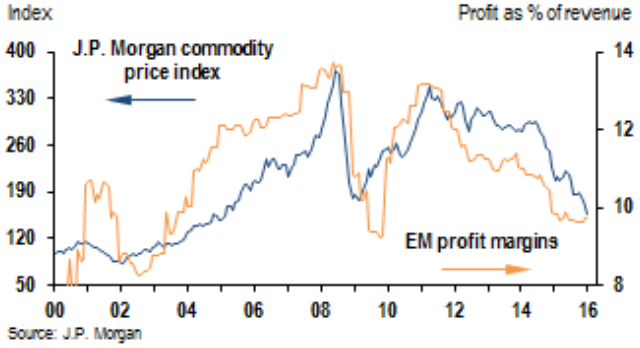
Commodities and EM corporate profit margins



EM profit margins

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Global Daily Economic Calendar

Global data releases: last 24 hours

	Last	Consensus	JPMorgan	Actual
Chile				
BCCh mtg	3.50	3.50	3.50	
Mexico				
IP (%oya, Dec)	0.1	0.3	0.1	0.0
Peru				
BCRP mtg	4.00	4.25	4.25	
Philippines				
BSP mtg	4.00	4.00	4.00	4.00
Russia				
Trade balance (bn USD, Dec)	9.1	10.0		11.0
Sweden				
Riksbank mtg	-0.35	-0.45	-0.45	-0.50
United States				
Yellen speaks to Senate				

Source: Bloomberg, J.P. Morgan

Global data releases: next 24 hours

	Last	Consensus	JPMorgan	Actual
Euro area				
GDP (%q/q, 4Q)	0.3	0.3	0.3	
IP (%m/m, Dec)	-0.7	0.3	0.1	
India				
IP (%oya, Dec)	-3.2	-0.5		
Hungary				
GDP (%oya, 4Q)	2.4	2.5	2.8	
Poland				
GDP (%oya, 4Q)	3.5	3.8		
Romania				
GDP (%oya, 4Q)	3.6	3.8	3.8	
United States				
Retail sales (%m/m, Jan)	-0.1	0.1	0.1	
Import prices (%m/m, Jan)	-1.2	-1.5	-1.3	
UMich cons conf (Index, Feb prlm)	92.0	92.3	91.5	
Bus inventories (%m/m, Dec)	-0.2	0.1	0.2	

Source: Bloomberg, J.P. Morgan